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IN THE UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
FRESNO DIVISION

In re

TULARE LOCAL HEALTHCARE
DISTRICT, dba TULARE REGIONAL
MEDICAL CENTER,

Debtor.

Tax ID #: 94-6002897
Address: 869 N. Cherry Street
Tulare, CA 93274

CASE NO. 17-13797

Chapter 9

DC No.: MRH-1

**RESPONSE OF TULARE LOCAL
HEALTHCARE DISTRICT TO REQUEST
FOR PAYMENT OF ADMINISTRATIVE
EXPENSE AND ADMINISTRATIVE
PROOF OF CLAIM**

Date: May 17, 2018
Time: 9:30 a.m.
Place: 2500 Tulare St.
Fresno, CA 93721
Courtroom 13
Judge: Honorable René Lastreto II

Debtor Tulare Local Healthcare District (the "District" or "Debtor") respectfully submits this response ("Response") to the "Request for Payment of an Administrative Expense and Administrative Proof of Claim" ("Request") filed by creditor Medline Industries, Inc. ("Medline") which seeks an order of this Court requiring the District to immediately pay Medline almost \$50,000.

1 **I. SUMMARY OF ARGUMENT**

2 Medline requests an order requiring the District to make immediate payment of
3 the sum of \$49,914.83 of which \$569.10 is sought as an administrative expense under
4 Section 503(b)(1) of the Bankruptcy Code (the "Code"), and \$49,345.73 is sought as an
5 administrative expense under Code § 503(b)(9). See, Request at p. 2, Ins. 25-27, p.3,
6 Ins. 1-4. Medline's Request for an order for immediate payment should be denied and
7 any adjudication on the allowance of its claim should be deferred because: (1) Medline's
8 request to adjudicate the merits of its claim is premature and Code § 904 provides that
9 a court may not issue any order interfering with a chapter 9 debtor's revenues, property,
10 or the use or enjoyment of any income-producing property unless the chapter 9 debtor
11 consents or the plan so provides; (2) there are no necessary costs and expenses of
12 preserving the estate under Code § 503(b)(1)(a) in a chapter 9 case; and (3) even if the
13 court chooses to adjudicate the merits of Medline's claim, Medline has failed to meet its
14 evidentiary burden to establish its claim as an administrative expense for the reasons
15 set forth herein and the separate evidentiary objections filed with this Response.

16 **II. BRIEF STATEMENT OF FACTS**

17 The District filed its emergency petition under chapter 9 of the Code on
18 September 30, 2017 ("Petition Date") after: (1) its former manager, Health Care
19 Conglomerate Associates ("HCCA"), threatened to cease operations at the hospital
20 known as the Tulare Regional Medical Center ("TRMC") and other medical facilities
21 which would have created a health and safety emergency for patients and the public
22 seeking medical care; and (2) the District first learned it was insolvent on September
23 28, 2017 when HCCA advised the District that it had a critical liquidity crisis, it was
24 completely out of cash, and it could not fund the entire gross payroll.¹ In light of the
25 District's dire financial crisis and HCCA's threats to cease operations, the District was
26 forced to voluntarily cease operations on or about October 29, 2017 in order to avoid a
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28 ¹ See, Docket No. 115 at pp. 160-61.

1 forced shut down by the California Department of Public Health. TRMC and the
2 District's medical clinics that provide patient care services remain closed at this time.²

3 Medline asserts the District should be ordered to make immediate payment of
4 \$49,345.73 for goods allegedly provided after and during the 20 days prior to the
5 Petition Date. However, Medline has failed to present any admissible evidence to: (a)
6 identify or even describe the goods provided, (b) demonstrate how any such goods
7 were reasonable and necessary to the District's operations or to preserve the District's
8 assets, and (c) establish the date(s) on which such goods were allegedly received by
9 the District. For the reasons set forth below, Medline's request for immediate payment
10 of any amount should be denied and any decision on the allowance of its claim should
11 be deferred until this Court established procedures for objecting to the allowance of
12 claims and/or the District proposes and confirms its plan of adjustment.

13 **III. ARGUMENT**

14 A proceeding under chapter 9 of the Bankruptcy Code differs in a number
15 respects from cases filed under chapter 7 or 11. Two of the key differences are
16 limitations on the scope of a bankruptcy court's authority over chapter 9 debtors under
17 Code § 904 and what claims constitute administrative claims.

18 **A. Courts Do Not Have Jurisdiction Or Authority To Issue Orders That** 19 **Interfere With The Property, Revenues, Or Use Or Enjoyment Of** 20 **Income Producing Property Of A Chapter 9 Debtor Unless The** 21 **Debtor Consents Or It Is Pursuant To A Plan**

22 Unless a chapter 9 debtor consents or a plan so provides, Code § 904 limits the
23 court's power and jurisdiction over, among other things, the property and revenues a
24 chapter 9 debtor or its use or enjoyment of any income-producing property. 11 U.S.C. §
25 904; *Ass'n of Retired Employees of the City of Stockton v. City of Stockton (In re City*
26 *of Stockton)*, 478 B.R. 8, 13 (Bankr. E.D. Cal. 2012) (Code § 904 bars the court,

27 _____
28 ² The District has been working diligently on multiple options to secure the requisite
financing and partner with third parties to reopen TRMC and the medical clinics.

1 without the municipality's consent, from interfering with its political or governmental
2 powers, property or revenues, and use or enjoyment of income-producing property); *In*
3 *re Valley Health Sys.*, 429 B.R. 692, 714 (Bankr. C.D. Cal. 2010) ("By virtue of § 904, a
4 debtor in chapter 9 retains title to, possession of, and complete control over its property
5 and its operations, and is not restricted in its ability to sell, use, or lease its property.").

6 By expressly limiting a court's authority to interfere with a chapter 9 debtor's
7 assets, Code § 904 protects the constitutionality of chapter 9 under the Tenth
8 Amendment.

9 "The bill here recommended for passage expressly avoids any restriction on the
10 powers of the States or their arms of government in the exercise of their
11 sovereign rights and duties. No interference with the fiscal or governmental
12 affairs of a political subdivision is permitted. The taxing agency itself is the only
13 instrumentality which can seek the benefits of the proposed legislation. No
14 involuntary proceedings are allowable, and no control or jurisdiction over that
15 property and those revenues of the petitioning agency necessary for essential
16 governmental purposes is conferred by the bill"

17 H.R. Rep. No. 95-595, at 264 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6222;
18 *United States v. Bekins*, 304 U.S. 27, 51 (1938) (approving foregoing statements of
19 Committee on the Judiciary of the House of Representatives in upholding the
20 constitutionality of Chapter X of the Bankruptcy Act under the Tenth Amendment to the
21 United States Constitution). In 1975, Congress further narrowed the power of courts to
22 interfere with a municipal debtor's assets by removing from their discretion the
23 determination of whether or not the assets are "necessary for essential governmental
24 services." See H.R. Rep. No. 94-686, at 18 (1975), reprinted in 1976 U.S.C.C.A.N.
25 539, 556.

26 The District does not consent to any order directing that its property or revenues
27 be used to satisfy Medline's asserted administrative claim, and the District has not yet
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1 proposed its plan of adjustment. For these reasons, the court lacks jurisdiction and
2 authority to issue any order requiring payment of Medline's asserted claim.

3 **B. It Is Premature To Consider The Merits Of Medline's Claim**

4 Even if the Court had jurisdiction and authority to issue the order Medline
5 requests, it is premature to consider the merits of Medline's asserted claim. As of the
6 date of the filing of this Response, this Court has not established procedures for the
7 adjudication of the merits of claims filed in the chapter 9 case. Nearly 250 proofs of
8 claim have been filed in this chapter 9 case, and it is critical to the efficient
9 administration of the case and to preserve the District's limited assets that it not be
10 required to litigate each claim before it proposes and confirms a plan of adjustment and
11 establishes procedures for the efficient administration of claims as part of its plan of
12 adjustment. Over the last few months, the District has devoted substantial resources
13 to diligently working to obtain the necessary funding to reopen TRMC and other patient
14 care clinics and to identify a well-established local partner to assist it in that endeavor.
15 It has also devoted substantial resources to efforts to resolve the disputes with HCCA
16 (its former manager). These are important steps in moving forward in its chapter 9
17 case so that the District is better able to determine what resources will be available in
18 connection with its plan of adjustment. For these reasons, the District believes it is
19 premature and not productive to litigate the merits of any claims at this point. Indeed,
20 the terms of a plan of adjustment may moot the need for any litigation.

21 **C. Bankruptcy Code § 503(b)(1)(A) Does Not Apply in Chapter 9**

22 In a chapter 7 or 11 case, claims arising under Section 503(b)(1)(A) for "the
23 actual, necessary costs and expenses of preserving the estate," are allowable
24 administrative expenses. In contrast, in a chapter 9 case there is no estate. *Diamond Z*
25 *Trailer, Inc. v. JZ L.L.C. (In re JZ L.L.C.)*, 371 B.R. 412, 419 n.4 (B.A.P. 9th Cir. 2007);
26 *In re City of Vallejo*, 403 B.R. 72, 78 n.2 (Bankr. E.D. Cal. 2009); *In re Jefferson*
27 *County, Ala.*, 484 B.R. 427, 460-61 (Bankr. N.D. Ala. 2012). At least two courts have
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1 held that there can be no “necessary costs and expenses of preserving the estate” in a
2 case where no estate exists. *In re New York City Off Track Betting Corp.*, 434 B.R.
3 131, 142 (Bankr. S.D.N.Y. 2010) (“*Off Track Betting*”); *In re Texas Wyoming Drilling,*
4 *Inc.*, 486 B.R. 746, 759 (Bankr. N.D. Tex. 2013)(no administrative claim exists where
5 there is no estate to benefit); *In re City of San Bernardino*, Dkt. No. 2164 at ¶ 16 at pp.
6 23-24 and Plan attached as Exhibit A thereto at Article I.B.16. at p. 4 and Article II.A at
7 p. 17 (Bankruptcy court approved plan of adjustment that provided that claims arising
8 under section 503(b)(1)(A) are not allowable administrative expenses).

9 In *Off Track Betting*, the court considered motions of several creditors to compel
10 the chapter 9 debtor to pay certain fees that had accrued post-petition. The court
11 rejected the argument that those fees were entitled to administrative priority under
12 Code § 503(b)(1)(A). The court reasoned that because a chapter 9 debtor’s property
13 remains its own and does not inure into any bankruptcy estate under Code § 541, there
14 can be no administrative expenses for ‘the actual and necessary costs of preserving
15 the estate’ as contemplated by Code § 503(b)(1)(A). *Off Track Betting*, 434 B.R. at
16 142. The court’s conclusion is in accord with and required by Code § 904, which
17 prevents bankruptcy courts from exercising jurisdiction over a municipality’s use of its
18 revenues without the municipality’s consent as discussed above.

19 The Supreme Court has held that statutes allowing administrative priorities in
20 bankruptcy “must be tightly construed.” *Howard Delivery Serv. v. Zurich Am. Ins. Co.*,
21 547 U.S. 651, 667, 126 S. Ct. 2105, 2116 (2006). “[I]f one claimant is to be preferred
22 over others, the purpose should be clear from the statute.” *Id.* (quoting *Sampsell v.*
23 *Imperial Paper & Color Corp.*, 313 U.S. 215, 61 S. Ct. 904 (1941)). “We take into
24 account, as well, the complementary principle that preferential treatment of a class of
25 creditors is in order only when clearly authorized by Congress.” *Id.* at 655 (citing
26 *Nathanson v. NLRB*, 344 U.S. 25, 29, 73 S. Ct. 80 (1952)).

1 Because the Bankruptcy Code does not expressly provide for the payment of
2 section 503(b)(1)(A) claims in chapter 9 cases, this Court should not read Section
3 503(b)(1)(A) more broadly than the statute's plain meaning. Congress did not clearly
4 authorize a priority for post-petition claims against a chapter 9 debtor. Congress could
5 have done so by stating in Code § 902(1) that "estate" when used in the Bankruptcy
6 Code sections made applicable to chapter 9 means "the debtor," as Congress did with
7 respect to "property of the estate." Alternatively, Congress could have written section
8 503(b)(1)(A) to provide for administrative priority for "the actual, necessary costs and
9 expenses of preserving the debtor and the estate," but Congress limited that provision
10 to claims against the estate. Because there is no estate in chapter 9, Code §
11 503(b)(1)(A) simply does not apply in chapter 9. In light of the constitutional concerns
12 in *Bekins* discussed above that led to Congress to enact section 904 (substantially
13 limiting the jurisdiction of the bankruptcy courts over a chapter 9 debtor's property and
14 revenues), the Court should not expand the reach of section 503(b)(1)(A) unless doing
15 so is "clearly authorized by Congress" and "the purpose of doing so is clear from the
16 statute." See, *Nathanson, supra*, 344 U.S. at 29; *Howard Delivery Service, supra*, 547
17 U.S. at 667. For these reasons, Medline's request for payment of an administrative
18 claim in the amount of \$569.10 for goods allegedly received after the Petition Date
19 should be denied.

20 **D. Medline's Has Not Established Any Administrative Claim Under 11**
21 **Code § 503(b)(9)**

22 Even if the Court chooses to consider the merits of Medline's claim at this early
23 stage before a plan of adjustment is proposed, for the reasons set forth in the
24 evidentiary objections filed with this Response, Medline has not submitted admissible
25 evidence to establish that it has an administrative claim under Code § 503(b)(9). The
26 District believes that the issue of whether claims arising under Code § 503(b)(9) are
27 allowable administrative expenses in chapter 9 case is an issue of first impression.
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1 Code § 503(b)(9) was added by the 2005 Bankruptcy Abuse Prevention and
2 Consumer Protection Act. The legislative history of § 503(b)(9) "suggests that it was
3 aimed at providing relief to sellers of goods who fail to give the required notice under
4 the reclamation provision of section 546(c)[.]" *In re Brown & Cole Stores, LLC*, 375 BR
5 873, (9th Cir. BAP 2007), *citing* Shirley S. Cho, *The Intersection of Critical Vendor*
6 *Orders and Bankruptcy Code § 503(b)(9)*, 29 Cal. Bankr. J. 7, 11 (2007), in turn *citing*
7 *BAPCPA, Pub. L. No. 109-8 at § 1227*. Code § 503(b)(9) allows as an administrative
8 expense "the value of any goods received by the debtor within 20 days before the date
9 of commencement of a case under this title in which the goods have been sold to the
10 debtor in the ordinary course of such debtor's business."

11 While the Bankruptcy Code does not define "goods," some courts have adopted
12 the UCC definition describing "goods" as all things – including specially manufactured
13 goods – that are movable at the time of identification to the contract for sale other than
14 the money in which the price is to be paid. *In re NE Opco, Inc.*, 501 BR 233, 241
15 (Bankr. D. Del. 2013). Goods are "received" under 503(b)(9) when the debtor or its
16 agent takes physical possession of them. *In re World Imports, Ltd.*, 862 F.3d 338 (3d
17 Cir. 2017).

18 The declaration of Donald Torres ("Torres Declaration") contains inadmissible
19 testimony because it does not comport with the Federal Rules of Evidence. The Torres
20 Declaration does not comport with Federal Rule of Evidence 602 because it does not
21 provide facts sufficient to show that the witness has personal knowledge of (a) whether
22 any materials or products provided by Medline were "goods" within the meaning of
23 Code § 503(b)(9) because no description of any materials or products is provided or
24 other documentation identifying any materials or products, (b) when any materials or
25 products were received by the District (instead there is only an inadmissible exhibit of
26 invoice dates), or (c) how any materials or products that may have been provided were
27 reasonable and necessary to the District's operations or to preserve the District's
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1 assets. In addition, the Torres Declaration has inadmissible opinion testimony because
2 it contains legal conclusions on whether any products or materials provided by Medline
3 were "goods," provided in the "ordinary course of business" and "reasonable and
4 necessary to the Debtor's operations and to preserve the Debtor's assets."
5 Furthermore, Exhibit A appended to the exhibits supporting the Request is inadmissible
6 because it does not contain facts sufficient to justify the use of a chart or summary to
7 prove the content of voluminous writings that cannot be conveniently examined in court
8 as required by Federal Rule of Evidence 1006. Thus, even if the Court considers the
9 merits of Medline's Request, it should be denied on this ground alone because there is
10 no admissible evidence to support any claim under Code § 503(b)(9).

11 **IV. CONCLUSION**

12 For the foregoing reasons, the District respectfully requests that the Court: (a)
13 deny Medline's Request for an order compelling the District to immediately pay it the
14 sum of \$49,914.83; (b) defer any adjudication of the merits of Medline's claim until after
15 a plan of adjustment is confirmed and a process is established for objecting to claims;
16 and (c) if the Court chooses to adjudicate the merits of the Request, deny Medline's
17 requested administrative claim and reclassify its claim as a general unsecured claim.

18 Dated: May 1, 2018

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21 By: 

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District